IVERSON, YOAKUM, PAPIANO & HATCH
624 South Grand Avenue, 27th Floor
Los Angeles, California 90017-3328

(213) 624-7444

Attorneys for Plaintiff
CHICAGO BRIDGE & IRON COMPANY

Plaintiff's Corporate Tax Counsel:

KENT J. SCHIELKE
Tax Counsel
CBI Industries, Inc.
800 Jorie Boulevard
Oak Brook, Illinois 60522-7001
(708) 572-7448

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

CHICAGO BRIDGE & IRON COMPANY
a corporation,
Plaintiff,
vs.
BOARD OF EQUALIZATION OF THE
STATE OF CALIFORNIA,
Defendant.

Case No. 712283

JOINT STIPULATION OF FACTS

Hearing
Date: May 3, 1990
Time: 8:30 A.M.
Place: Department 52

TO DEFENDANT BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA AND ITS ATTORNEY OF RECORD:

On behalf of itself and defendant and in furtherance of both parties' motions for summary judgment, plaintiff Chicago Bridge & Iron Company submits the following Stipulation of Facts.

IVERSON, YOAKUM, PAPIANO & HATCH
624 South Grand Avenue, 27th Floor
Los Angeles, California 90017-3328

(213) 624-7444

Attorneys for Plaintiff
CHICAGO BRIDGE & IRON COMPANY

Plaintiff's Corporate Tax Counsel:

Kent J. Schielke
Tax Counsel
CBI Industries, Inc.
800 Jorie Boulevard
Oak Brook, Illinois 60522-7001
(708) 572-7448

SUPERIOR COURT OF THE STATE OF CALIFORNIA
COUNTY OF LOS ANGELES

CHICAGO BRIDGE & IRON COMPANY
a corporation,

Plaintiff,

vs.

BOARD OF EQUALIZATION OF THE
STATE OF CALIFORNIA,

Defendant.

Case No. 712283

STIPULATION OF FACTS

IT IS HEREBY STIPULATED AND AGREED, by and between the parties hereto, through their respective counsel of record, that, for the purpose of trial in this complaint for recovery of California Use Tax, the facts stated in this Stipulation are undisputed and may be treated by the Court as facts proved in open court.

The parties may on the trial of this action call witnesses and offer evidence, or may stipulate to additional facts, for the purpose of proving such additional facts as the parties may see fit.

The undisputed facts are as follows:

1. Defendant Board of Equalization of the State of California ("Defendant Board") does not take issue with the figures and other primary accounting data from which plaintiff Chicago Bridge & Iron Company ("CB&I") derived its California Use Tax base and resulting liability. Rather, the dispute between the parties centers on the application of the law to CB&I's particular factual situation and the determination of the cost base upon which CB&I's California use tax is to be computed. (For purposes of this stiuplation, the term "California Use Tax base: shall be defined as the sales price to CB&I of all tangible personal property purchased or withdrawn from inventory for use in performing construction contracts in California.) Thus, to the extent that a resolution of the correct tax base is reached, the computation of the California use tax is straightforward and is not disputed. Once this determination is made, then, the parties are prepared to agree as to the correct amount of tax.

2. As set out in greater detail below, if the "short-ends" rule of California Administrative Regulation 1521(b)(6)(C) does not legally apply to the residual metal generated by CB&I at its Salt Lake City, Utah fabrication plant, in connection with the underlying fabrication of materials for contracts involving a field erection site in California, then CB&I is entitled to a refund in the amount of $191,469.97 on account of overstated California use tax, and $6,572.24 on account of penalties paid by CB&I to Defendant Board, together with interest as provided by law.

3. At all times material herein, CB&I was an Illinois corporation whose principal headquarters and place of business was and is located in Oak Brook, Illinois. During the period in issue, CB&I was qualified to do business in the State of California and performed business operations in the State of California.

4. CB&I's principal business operations and activities during the period in issue involved the design, engineering, fabrication, manufacture and field erection of large welded steel plate storage

tanks, nuclear containment vessels, blast furnaces, and other steel plate structures for the processing and storage of petroleum products, chemicals, and other liquids.

5. Defendant Board is and was at all times material herein the agency of the State of California charged by law pursuant to *California Rev. & Tax Code* § 7051 with the responsibility to administer and enforce the California Sales and Use Tax law, *Rev. & Tax Code* § 6001, *et seq.*

6. Defendant Board also administers the Uniform Local Sales & Use Tax Law, *Rev. & Tax Code* § 7202(d), and the Transactions and Use Tax Law, *Rev. & Tax Code* § 7270. In this capacity, Defendant Board is authorized and empowered to assess and collect use taxes on behalf of the State of California and to audit and examine sales and use tax returns filed with the State of California pursuant to the California Sales & Use Tax Law, the Uniform Local Sales & Use Tax Law, and the Transactions and Use Tax Law.

7. The subject matter of this action involves a determination of the correct amount of use taxes that should have been paid by CB&I to the State of California during the period from January 1, 1978 through December 31, 1982, inclusive (hereinafter sometimes referred to as the "years 1978 through 1982"), pursuant to the California Sales & Use Tax Law, *Rev. & Tax Code* §§ 7200-7209, and the Transactions and use Tax Law, *Rev. & Tax Code* §§ 7251-7273, and includes the Bay Area Rapid Transit District (BART) tax imposed by selected Northern California Counties at the rate of ½ of 1% during the period in issue.

8. CB&I brings this action against Defendant Board under the authority of Sections 6933 and 6934 of the *California Rev. & Tax Code.* Jurisdiction of this action, which involves among other things the legality of a tax, is vested in the Superior Court by virtue of *California Code of Civil Procedure* § 86(a)(1) and California Constitution Article VI, Section 10.

9. During the period in issue, CB&I performed a number of real property improvements ("construction contracts" or "contracts") that required the erection or emplacement at sites within the State of California of tanks, vessels, or other large contain-

ment structures ("containment structure(s)"). Except for contracts filled from CB&I's Fontana, California plant and work performed in connection with the actual erection or emplacement at the field sites of containment structures, most of the services performed by CB&I in connection with such contracts were rendered outside the State of California. Contracts filled from CB&I's Fontana plant are not the subject of this refund action.

10. CB&I was a construction contractor and not a seller of tangible personal property. Accordingly, California Administrative Regulation 1521(b)(2)(A)1 establishes that CB&I was the consumer of any material that it furnished and installed in the performance of a construction contract. As the consumer, CB&I was liable for California use tax measured by the sales price to CB&I of materials incorporated into the finished structures. CB&I was not entitled to pass this tax onto its customers in the form of a separately stated charge. Thus, CB&I's payment of such use tax constituted a cost and, like all other costs to CB&I was included in the lump-sum construction contract price. Any additional use tax liability, such as that proposed by defendant Board, is paid solely by CB&I and is not passed on to its customers.

11. A significant portion of the services necessary to fulfill CB&I's construction contracts were performed at its fabrication plant in Salt Lake City, Utah where steel plate was cut, rolled and fabricated into component parts ("subassemblies") which, when assembled, constituted the containment structures erected at various construction locations in California and throughout the western United States.

12. CB&I prepared its lump-sum construction contract price quotations by determining its steel costs based upon the tonnage of steel that would be incorporated into the final containment structure. CB&I purchased the component steel used at its Utah fabrication plant from various steel mills (herein predominately Geneva Steel) on a price-per-pound basis from published steel mill lists. The material cost estimate was based on tonnage times the established price. At the bid formation stage, CB&I projected, with as much accuracy as possible, its steel cost along with all other costs attributable to the performance of a particular construction contract.

13. CB&I ordered most of its steel for a specific containment structure after a contract had been awarded. These orders were customized in terms of specific widths and lengths in order to suit the specific design and structural requirements of a particular contract. The volume of residual steel produced was inversely related to the accuracy with which the steel ordered by CB&I suited the structural requirements of a contract: the more nearly suited the steel was to the contractual requirements, the less the amount of residual steel produced. In turn, a reduction in the volume of residual steel produced resulted in a proportionate reduction in CB&I's fabrication costs.

14. For purposes of cost accounting, CB&I identified steel plate ordered for specific contracts as "contract metal". CB&I used contract metal primarily for the ring or wall plates of containment structures for which exact thicknesses and grades were essential. CB&I purchased contract metal directly from steel mills as a *commodity* on a unit price per pound basis. Contract metal was specifically earmaked from the time of purchase until the completion of the fabrication process for use on a particular contract. At all times during the fabrication process, CB&I accounted for contract metal separately, never commingling it with CB&I's stock inventory ***unless*** reusable residual metal, such as that described in Paragraph 18 of this Stipulation, resulted from the fabrication process, in which case such residual metal was returned to inventory.

15. In addition to contract metal, CB&I also maintained an inventory of steel plate that was separately identified as stock metal".

16. Stock metal consists of steel plates that had a common size and thickness and that were capable of being used on a number of different projects. Typically, stock metal was used for the bottoms and roofs of the standard flat-bottom and cone-roof style tanks. Because stock metal was part of CB&I's working inventory, it was not ordered in connection with the performance of a particular contract.

17. CB&I did not pay a use tax to the State of Utah on any contract metal that had been ordered by CB&I for a specific

contract involving a field erection site in the State of California. However, CB&I typically paid use tax to the State of Utah on all of its stock metal inventory purchased for its fabricating plant in Salt Lake City, Utah. With respect to CB&I's California use tax liability for the period in issue, CB&I claimed and received from Defendant Board a credit with respect to the use taxes previously paid by CB&I to the State of Utah, as permitted by *Rev. & Tax. Code* § 6406. This credit has not been challenged and is not at issue in this action.

18. Notwithstanding CB&I's efforts to minimize its costs by reducing scrap and otherwise unused steel plate, a certain amount of steel plate (residual metal) remained after the fabrication process as a result of the cutting, rolling and manufacture of the component subassemblies. Based on the size, dimensions and general condition of the residual metal, CB&I then determined whether to treat the left over material as scrap or set it aside and return it to stock for use on another contract. Residual metal treated as scrap was later sold by CB&I to local Utah scrap dealers and the SBE's reliance on the sale of such scrap to aid in the determination of the measure of use tax is the subject matter of this dispute. Residual metal returned to stock for use on another contract was valued by CB&I for material-cost-estimate purposes in accordance with the then market price of steel plate.

19. Any residual metal not returned to stock by CB&I was typically resold to local Utah third-party purchasers. CB&I did not erect, ship or sell such residual metal into the State of California.

20. CB&I arrived at the percentage of metal purchased and sold outside the State of California by computing the total weight of steel imported into the Utah fabrication plant less the weight of the steel plate subassemblies exported from the plant to various California job site locations. Quarterly reports were generated since CB&I sold its residual metal to Utah purchasers on a quarterly basis.

21. CB&I timely filed its California Sales and Use Tax Returns with Defendant Board for ail quarters of each calendar year for the period between the years 1978 through 1982. CB&I

reported its use tax liability to the State of California on the basis of the methods described in this Stipulation and paid the taxes so reported as they fell due.

22. The sales and use tax base and amount of California sales and use tax paid in connection with each quarterly California Sales and Use Tax Return filed by CB&I for the years 1978 through 1982 were as follows:

Calendar Quarter Ending	Sales and Use Tax Base	California Sales and Use Tax Liability
03/31/78	$1,458,524.24	$ 90,168.50
06/30/78	1,161,223.03	70,053.11
09/30/78	1,982,454.75	120,071.72
12/31/78	3,838,822.75	236,431.29
03/31/79	692,304.35	42,892.45
06/30/79	1,864,494.36	114,890.17
09/30/79	2,440,811.16	149,457.67
12/31/79	2,918,302.51	178,302.25
03/31/80	686,618.16	41,423.30
06/30/80	1,434,481.00	87,845.82
09/30/80	2,579,027.00	157,347.05
12/31/80	790,407.00	50,787.74
03/31/81	1,224,107.25	78,264.78
06/30/81	3,727,619.00	238,140.43
09/30/81	820,687.00	52,460.44
12/31/81	2,704,975.01	170,668.60
03/31/82	2,808,269.59	180,046.95
06/30/82	1,437,964.41	93,037.63
09/30/82	844,901.32	54,071.97
12/31/82	3,354,792.02	216,669.20

23. Following an audit of CB&I's Sales and Use Tax Returns filed for the period in issue, Defendant Board determined that the methods used by CB&I to compute its California use tax base on the steel imported into California were incorrect. Defendant Board determined that the use tax base on such steel is equal to the sales price to CB&I of all steel purchased or withdrawn from

inventory for use on California jobs, minus the value of residual steel produced in the fabrication process and sold as scrap. Defendant Board further concluded that the value of the residual steel was equal to the proceeds derived by CB&I on such sales. As a result, Defendant Board determined that CB&I had made a net underpayment of its California use tax liabilities during the period in issue.

24. In support of its position, Defendant Board cited the "short-ends" rule of Regulation 1521(b)(6)(C), 18 *Cal. Ad. Code.*

25. Defendant Board subsequently issued Notices of Determination, pursuant to *Rev. & Tax Code* § 6486, for additional tax, interest and penalties owed by CB&I with respect to the period in issue.

26. CB&I paid in due course to Defendant Board the full amount of the tax deficiencies assesssed for the period in issue as a result of Defendant Board's recomputation of CB&I's use tax base.

27. Thereafter, CB&I timely filed claims for refund with Defendant Board for recovery of the total amount of additional California Use Tax paid on account of the subject deficiencies. A separate claim (attached hereto as Exhibit A) was filed in the following amounts for each of the five years included in the period in issue:

Year	California Use Tax	BART Use Tax	Total Claimed Overpayment
1978	$ 27,307.00	$ 434.00	$ 27,741.00
1979	$ 42,246.01	$1,818.69	$ 44,064.70
1980	$ 26,410.38	$ 389.84	$ 26,800.22
1981	$ 8,342.20	$ 213.36	$ 8,555.56
1982	$ 78,931.09	$5,377.30	$ 84,308.39
TOTALS	$183,236.68	$8,233.19	$191,469.87

Subsequently, CB&I has made a downward adjustment of its refund claim based upon California destination contracts as follows:

Year	Total Claimed Overpayment
1978	$14,872.56
1979	8,734.36
1980	3,396.64
1981	2,034.20
1982	51,884.06
TOTAL	$80,921.82

28. CB&I contends that its method of self-assessing and ascertaining its cost of materials actually imported into the State of California accurately reflects its true cost of the materials stored, used or consumed within the state. CB&I contends further that, based upon its ability to accurately compute the cost to it of materials actually stored, used or consumed in the State of California, and based upon its purchase and resale of residual metal outside the State of California, CB&I's California use tax base should be reduced by the actual cost to CB&I of residual metal rather than the nominal value given such residual metal by Defendant Board.

29. Defendant Board contends, on the other hand, that, insofar as the resale by CB&I of residual metal to third-party scrap dealers outside the State of California warrants an adjustment to CB&I's California use tax base, the base should be reduced by only the dollar amount that CB&I received from the local Utah dealers.

30. The following hypothetical illustrates the differing positions of Defendant Board and CB&I:

	Pounds	Defendant Amount	Plaintiff Amount
Contract Metal			
Volume of steel plate shipped to California erection site	81,000	N/A	N/A
Total cost of contract metal purchased for contract	90,000	$90,000.00	$90,000.00

	Pounds	Defendant Amount	Plaintiff Amount
Less			
Deduction from California use tax base allowed for sale of scrap	9,000	$ 900.00	$90,000.00
Net California use tax base	81,000	$89,100.00	$81,000.00
Total California use tax liability at 6.5%	81,000	$ 5,791.50	$ 5,265.00
Stock Metal			
Use tax paid at 5%	10,000	$ 500.00	$ 500.00
Volume of steel plate shipped to California erection site	9,000	N/A	N/A
Total cost of stock metal allocated to contract	10,000	$10,000.00	$10,000.00
Deduction from California use tax base allowed for sale of scrap metal	1,000	$ 100.00	$ 1,000.00
Net California use tax base	9,000	$ 9,900.00	$ 9,000.00
California use tax at 6.5%	9,000	$ 643.50	$ 585.00
Section 6406 credit allowed for use tax paid outside state of California		$ 500.00	$ 500.00
Total California use tax liability		$ 143.50	$ 85.00
Recapitulation			
California Use Tax Base			
Contract Metal		$89,100.00	$81,000.00
Stock Metal		$ 9,900.00	$ 9,000.00
Total		$99,000.00	$90,000.00
California Tax Paid			
Contract metal		$ 5,791.50	$ 5,265.00
Stock metal includes § 6406 credit)		$ 143.50	$ 85.00
Total		$ 5,935.00	$ 5,350.00
Difference in total California tax liability			$ 585.00

3.1 In sum, the difference in the California use tax base and use tax as determined by Defendant Board and CB&I results from Defendant Board's application of California Administrative Regulation 1521(b)(6)(C) to the residual metal generated during the period in issue at CB&I's Salt Lake City, Utah fabrication plant in connection with contracts involving a field erection site in California.

DATED: May 1, 1990

IVERSON, YOAKUM, PAPIANO & HATCH

By /s/ JOHN M. GARRICK
John M. Garrick
Attorneys for Plaintiff
CHICAGO BRIDGE & IRON

DATED: May 1, 1990

JOHN VAN DeKAMP,
Attorney General
DAVID S. CHANEY,
Deputy Attorney General

By /s/ DAVID S. CHANEY
David S. Chaney
Attorneys for Defendant
BOARD OF EQUALIZATION OF THE STATE OF CALIFORNIA